***American Nurseryman Publishing Co. v. Commissioner, 70 T. C. 279 (1978)***

The transfer of stock to a trust, even if later voided by a state court, terminates a corporation's Subchapter S election for federal tax purposes.

**Summary**

In American Nurseryman Publishing Co. v. Commissioner, the Tax Court ruled that the transfer of stock by a shareholder to a revocable trust terminated the corporation's Subchapter S election, despite a subsequent state court ruling that the transfer was void ab initio. The case centered on Colleen Kilner's transfer of her shares to a trust in 1975, which the IRS argued disqualified the company from Subchapter S status. The court upheld the IRS's position, emphasizing that federal tax consequences of a completed transaction cannot be retroactively altered by state court decisions. This ruling underscores the importance of strict adherence to the formalities required for maintaining Subchapter S status and the limitations on state court influence over federal tax law.

**Facts**

Colleen B. Kilner, a shareholder of American Nurseryman Publishing Co. , transferred 223 shares of the company to a revocable trust on July 11, 1975, where she served as the sole beneficiary and trustee. The trust was set to continue with a bank as trustee upon her death. Following Kilner's death in May 1976, the bank, acting as executor, initiated a proceeding in an Illinois court, which declared the transfer void ab initio due to Kilner's mistake. Despite this, the IRS maintained that the transfer had terminated the company's Subchapter S election for 1975, leading to a tax deficiency assessment.

**Procedural History**

The IRS determined a deficiency in the company's 1975 federal income tax due to the termination of its Subchapter S election. The company petitioned the Tax Court to challenge this determination. The Tax Court upheld the IRS's position, ruling that the transfer of stock to the trust had indeed terminated the election.

**Issue(s)**

1. Whether the transfer of stock by Colleen Kilner to a revocable trust terminated the corporation's Subchapter S election for federal tax purposes in 1975.
2. Whether the subsequent Illinois court order declaring the transfer void ab initio retroactively changed the federal tax consequences of the transfer.

**Holding**

1. Yes, because the transfer of stock to a trust, which is not an eligible shareholder under Subchapter S, terminated the election in 1975.

© 2025 SCOTUSreports.com. All rights reserved. 

2. No, because federal tax law does not recognize the retroactive effect of state court decisions on completed transactions for tax purposes.

**Court’s Reasoning**

The court applied the Internal Revenue Code’s provisions on Subchapter S corporations, which clearly state that a trust cannot be a shareholder. The court emphasized the IRS regulations’ consistent interpretation that any transfer of stock to a trust terminates the election, regardless of the trust’s revocability or the grantor’s control. The court rejected the company’s argument that the substance of the transaction should prevail over its form, citing the legislative intent to simplify the tax treatment of small businesses. The court also held that the Illinois court’s order declaring the transfer void could not retroactively change the federal tax consequences of the completed transaction, citing precedents like Van Den Wymelenberg v. United States. The court concluded that the regulations were valid and upheld the termination of the Subchapter S election for 1975.

**Practical Implications**

This decision underscores the need for strict adherence to Subchapter S eligibility rules, particularly regarding shareholder status. Corporations must ensure that any transfer of stock does not inadvertently terminate their election, as even temporary transfers to trusts can have significant tax implications. The ruling also highlights the limited influence of state court decisions on federal tax law, advising practitioners to be cautious about relying on state court remedies to alter federal tax outcomes. Subsequent legislative changes allowing certain trusts to hold Subchapter S stock reflect the complexities addressed by this case, but these changes were not retroactive, leaving similar situations to be governed by the principles established here.

© 2025 SCOTUSreports.com. All rights reserved. 